IT 99-15
Tax Type: **Income Tax**
Issue: **Withholding Tax – Failure to File Return/Make Payment**

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STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

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THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS
 	
     v.
 	
"SCRATCH PAD STATIONERS, INC.",
     Taxpayer
	No. 98-IT-0000
	FEIN: 36-0000000
	
	Christine O'Donoghue
	Administrative Law Judge

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RECOMMENDATION FOR DISPOSITION

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Appearances: Ms. Kathryn Michaelis, Special Assistant Attorney General for the Illinois Department of Revenue

Synopsis:

This matter arose as a result of a timely protest to the Notice of Deficiency ("NOD") issued to "Scratch Pad Stationers, Inc.", ("taxpayer") for the fourth quarter of 19xx and the second quarter of 19xx. The issues are 1) whether the proposed tax assessment was discharged in bankruptcy, 2) whether the Department should be barred by laches from finalizing the liability and 3) whether the Department assessed the proper amount of withholding tax for the second quarter of 19xx. After consideration of the

evidence presented, it is my recommendation that this matter be resolved in favor of the Department of Revenue on all issues.

Finding of Facts:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by admission into evidence of the Notice of Deficiency proposing an assessment of $448.91 against "Scratch Pad Stationers, Inc." for failure to file tax returns and pay withholding taxes for the fourth quarter of 19xx and the second quarter of 19xx. Dept. Group Ex. No. 1.

2. The Department has abated the Section 1001 penalty and the interest on the Section 1001 penalty but it has not revised the total amount of tax as shown due on the NOD. Dept. Ex. No. 1; Tr. pp. 7, 8.

3. The batch numbers on the taxpayer's four checks in evidence are identical to the batch numbers listed on the Department's W815I Withholding Tax System, Payment History Display and reflect that upon receipt the four check payments were applied to the taxpayer's account. Compare Taxpayer Ex. No. 1 to Dept. Ex. No. 2 pp. 2, 5, 6.

Conclusions of Law:

The Department has proposed an assessment against the taxpayer pursuant to Sections 705 and 904 of the Illinois Income Tax Act (hereinafter "IITA") for failure to file its IL-941 tax returns and for failure to pay over to the Department the tax withheld from its employees' compensation as required by Section 701 of the IITA. 35 **ILCS** 5/904; 35 **ILCS** 5/704; 35 **ILCS** 5/705. The Notice of Deficiency was issued for the fourth quarter of 19xx and the second quarter of 19xx.

At hearing, the taxpayer challenged this proposed assessment and argued that the Department may not finalize the proposed assessment at this time because it failed to file a claim in Bankruptcy Court. Secondly, the taxpayer contended the Department is barred by laches from finalizing this proposed assessment and finally, it argued that the amount of tax shown due on the NOD is incorrect because the taxpayer paid the taxes timely, thereupon it submitted cancelled checks at the hearing to support its position. Tr. p. 6.

With respect to whether the taxes at issue were discharged in bankruptcy the Bankruptcy Act is clear. Certain types of taxes are non-dischargeable pursuant to 11 USC 523(a)(1)(A) including those taxes listed in Section 507(a)(8) of Title XI.

Section 523(a)(1)(A) states:

(a) A discharge under section 727, 1141, 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
(1) for a tax or a customs duty—
(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this tile, whether or not a claim for such tax was filed or allowed; …

Further, § 507(a)(8)(C) provides:

(a) The following expenses and claims have priority in the following order:
(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—
(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

Section 507(a) sets forth a description of the types of debts that have priority in the distribution of assets in a bankruptcy estate and specifies the order in which they are to be paid. "Section C covers the "so-called 'trust fund' taxes, that is, income taxes which an employer is required to withhold from the pay of his employees, … ." S. Rep. No. 95-

989, 95th Cong.2d Sess. 71 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5857; *see*, In re Rosenow, 715 F.2d 277, 279 (7th Cir. 1983). The plain language of the statute reveals that withholding taxes cannot be discharged, furthermore, it is not conditioned upon the Department filing a claim in Bankruptcy Court. Thus, the Department is not preempted from issuing an administrative determination regarding the NOD in the matter at hand.

Secondly, the taxpayer contends that the equitable doctrine of laches should be applied in the instant case to bar finalizing the proposed assessment. Generally, the courts will apply laches when a party has failed to act with due diligence by timely asserting a right and this inaction results in prejudice to the opposing party. Tully v. State, 143 Ill.2d 425 (1991). An exception to this generally principal exists, however, in that the equitable doctrine of laches is applied against a governmental entity's actions only if extraordinary circumstances, such as fraud, are shown, thereby ensuring governmental bodies will not be impaired in the discharge of their government functions and public revenues will be protected. Hickey v. Illinois Central R.R. Co., 35 Ill.2d 427 (1966); Austin Liquor Mart, Inc. v. Department of Revenue, 51 Ill. 2d 1.

In this case, the evidence does not warrant barring the Department from finalizing the proposed assessment of withholding tax shown on the Notice of Deficiency. It is unreasonable for the taxpayer to argue that it was led to believe the Department was abandoning its right to such taxes merely because it chose an administrative forum rather than Bankruptcy Court. More importantly, the facts do not establish fraudulent conduct on the Department's part nor is there evidence the taxpayer suffered an injustice on

account of the Department's actions. Accordingly, I cannot find that the equities support the taxpayer's position.

Lastly, the evidence presented by the taxpayer does not support its contention that the amount of withholding tax due as determined on the NOD is incorrect. Section 904 provides that the Department's *prima facie* case is established by the admission into evidence of the Notice of Deficiency. Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1981). The Department's determinations are rebutted only after a taxpayer introduces documentary evidence that is consistent, probable and identified with taxpayer's books and records and shows the Department's determinations to be incorrect. Id.

At hearing the taxpayer argued that he believed the Department's calculations were inaccurate because the corporation paid the correct taxes timely and at hearing submitted four cancelled checks to prove its contention. Tr. p. 6. It maintained the Department acknowledged errors on the NOD and the proposed assessment was reduced from approximately $400.00 to $243.00 plus interest. Taking the four check payments into account, the remaining balance due was $34.00. Tr. pp. 6, 7. The Department disputed this and stated that the NOD was only revised to abate the penalty and the interest on the penalty, the total amount of tax due has remained consistent. Tr. pp. 7, 8.

Despite allegations to the contrary, the evidence of record unquestionably proves the taxpayer's contentions are without merit. The Department's W815 printout, the "Withholding Tax System Payment History," offered under the Certificate of the Director as Dept Ex. No. 2, outlines the taxpayer's payments for the six consecutive quarters running from the first quarter of 19xx through the second quarter of 19xx. Tr. p. 19. This printout enables one to match a cancelled check with a specific payment listed on this

document by comparing the 10 digit batch number on the back of the cancelled check to the batch numbers listed on the W815 printout to determine the manner in which the payment was applied against the taxpayer's liability. Tr. p. 20. The first five digits of the batch number represent the year it was received and the day it was stamped for internal control purposes, the remaining digits refer to the type of return and other pertinent information. Comparing the batch numbers on the cancelled checks to the batch numbers listed on the Department's printout reveals the four checks presented at hearing were applied to the following quarters:

Check No.	Amount	Quarter
1866	$ 78.15	1st quarter of 19xx
1896	68.97	2nd quarter of 19xx
1907	61.75	2nd quarter of 19xx
1911	67.65	2nd quarter of 19xx

The NOD reflected that the taxpayer did not file IL-941s for the two quarters at issue, therefore, the Department determined the liability based upon previous filings. Three of the four checks were applied to quarters other than the second quarter of 19xx because the Department's records reflected that the payments received for these quarters (the second quarter of 19xx and the first quarter of 19xx) were less than the tax due, thereby resulting in a balance due.

At hearing, the taxpayer did not produce any books and records to prove the Department's determination of the tax due was incorrect or that the Department was unjustified in its application of the payments. Taxpayer merely argued that the checks were applied to the wrong quarters, however, these assertions without corroborating documentary evidence do not successfully rebut the *prima facie* correctness of the tax determined on the NOD. Moreover, the Department's withholding payment printout

unquestionably proves that the taxpayer was given proper credit for the four checks presented at hearing.

Wherefore, for the reasons stated above, it is recommended that the Notice of Deficiency, as amended by the Department, be finalized.

Date: June 1, 1999   _____
                                      Christine O'Donoghue
                                      Administrative Law Judge